

# How Older Family Businesses Can Keep the Magic Going

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Many family businesses grow and thrive in the first generation because of the passion and commitment of their founders. Successive generations often don't share that same level of dedication, and the business suffers as a result. As new generations assume management roles in well-established, thriving businesses, these new leaders may not be willing to "rock the boat" with innovation because they are satisfied with the status quo that they associate with their financial comfort.

However, innovation is essential to the long-term survival of both family and non-family firms. Firms that offer shares to the public face stockholder pressure to continue to deliver results, which encourages innovation for growth. At family firms, where the wealth created by the business accrues largely to the family, studies show that innovation declines over successive generations. Overall, family firms invest less on average in innovation than non-family firms.

In a 2011 study

(<https://www.sciencedirect.com/science/article/abs/pii/S1877858517301031>) , we set out to discover what keeps older family firms innovating, even when things are humming along and the owners are enjoying a comfortable income. We discovered that in the older family firms that still managed to innovate, the generation in charge felt a psychological ownership of their firm, as well as the legal ownership that gives them the power to decide and the financial benefits of innovation. By "psychological ownership," we mean that their role in the business is fulfilling three basic human needs: to feel competent, to have self-identity and to belong somewhere. In a nutshell, the family CEO with a high level of psychological ownership reflects upon the business day in and day out and. Psychological ownership allows leader to consider possible changes, look out for improvements and be open to opportunity.

Our study looked at nearly 1,000 German firms where at least half of the ownership was in the hands of a family and at least one family member was in the top management team. About half of those firms were first-generation family firms; 25% were controlled by the second generation and 24% by the third. We surveyed the CEOs of those companies about their level of innovation, by asking several questions about new products or services or improved processes introduced over the previous three years.

To get a sense of psychological ownership, respondents were asked to rate how they felt about several statements, including "This is OUR company," "I sense that this organization is OUR company," "It is hard for me to think about this organization as MINE," and others that gauged their level of psychological connection. We controlled for other factors that influence innovation, such as the type of industry (for example, IT services and biochemistry are naturally more innovative industries) and area of the country (some parts of Germany are known as innovation hubs).

Our results showed that while innovation in family firms declined in the later generation firms, firms where the people in charge felt a strong psychological ownership overcame this tendency. About half of our older family firms in our data showed both, a dramatically low level of psychological ownership and a dramatically low level of innovative output. However, we also saw that the level of innovation at third-generation firms with deep psychological ownership was as strong as that of younger family firms where the founder was in charge. CEOs with high levels of legal and psychological ownership have both, the incentive to make things happen and the power to do so.

## The Takeaway

This study generates some cues for family businesses to think about.

- Often family businesses think about the tangibles, but must also think about “soft side” issues such as psychological ownership for longevity.
- Legal ownership is not enough to spur innovation. Psychological ownership is equally important because it motivates top managers to leverage their legal rights to spur change in the organization.
- While legal ownership can be inherited, psychological ownership must be passed down, instilled in each successive generation, and nurtured. This means teaching values early, involving the next generation from childhood onwards, and encouraging future generations to get the education and experience they need to assume leadership of the family business. Consequently, keeping a high level of psychological ownership is especially important in family businesses passed on to later generations.
- Family business CEOs should look for ways for family members with only small legal ownership to make contributions to the business. This means nurturing a feeling of psychological ownership but at the same time defining clear roles and responsibilities that come with it.

## References

Rau, S., Werner, A. and Schell, S. [Psychological Ownership as a Driving Factor of Innovation in Older Family Firms](https://www.sciencedirect.com/science/article/abs/pii/S1877858517301031) (https://www.sciencedirect.com/science/article/abs/pii/S1877858517301031) , Journal of Family Business Strategy, December 2019